Verizon Communications
1300 I Street NW, Suite 400W
Washington, DC 20005

March 8, 2002

Ex Parte

William Caton
Acting Secretary
Federal Communications Commission
445 12th St., S.W. – Portals
Washington, DC 20554

RE: Application by Verizon-New Jersey Inc. for Authorization To Provide In-Region, InterLATA Services in State of New Jersey, Docket No. 01-347 - **REDACTED**

Dear Mr. Caton:

During the past week, AT&T has submitted two ex parte filings which contain — for the first time — detailed criticism of Verizon's non-recurring hotcut rates. In addition, AT&T provides (without a cost study) its own estimate of the non-recurring costs to provision a hotcut. In light of the extensive procedures that Verizon has put in place at the request of AT&T and other CLECs to make sure that hotcuts are provisioned without any service interruption, AT&T's newly-minted estimates are simply not credible.

As an initial matter, the newly filed ex partes are the first time in the current proceeding that AT&T has attempted to provide substantive support for its claim that the hotcut NRC set by the Board is somehow too high. In its comments to this Commission, AT&T vaguely asserted that this rate was too high, without any substantial support for that claim. Before the Board, while AT&T did address issues relating to non-recurring charges generally, AT&T submitted limited testimony on the hotcut issue, and failed to rebut the extensive evidence submitted by

Verizon demonstrating step-by-step the process that was developed through carrier-to-carrier collaboratives for completing hotcuts. In fact, to the extent AT&T did address hotcuts in particular, Verizon provided detailed testimony refuting AT&T's claims in the state proceeding, *see Verizon February 20 Ex Parte*, Attachment 3 (Meacham Rebuttal), and AT&T declined to ever cross-examine Verizon's witness on the issue, *see Verizon February 20 Ex Parte* at 7.

I. Verizon Has Properly Amortized Non-Recurring Hotcut Costs to Demonstrate that Those Costs Are Lower in New Jersey Than Elsewhere.

In response to AT&T's initial vague criticism of the non-recurring hotcut rates as somehow too high merely because some states had set different rates, Verizon demonstrated that if the recurring and non-recurring hotcut rates are combined and amortized over three years, the combined rates are lower or the same in New Jersey as those in Massachusetts or Pennsylvania, and lower than the costs determined by New York. *See* Reply Declaration of Patrick A. Garzillo and Marsha S. Prosini ("*Garzillo/Prosini Reply Declaration*") ¶ 28. This Commission previously has found that such an amortization is an appropriate means of analyzing the total cost of purchasing unbundled elements. *See Arkansas/Missouri Order* ¶ 71 n.207 (explaining that "[w]hen compared to the recurring cost of the element and the length of time the NRC would likely be amortized, the price differences [compared to other states] are less significan[t]"). Indeed, because CLECs will only pay the non-recurring hotcut rate *in conjunction with* the recurring loop rate, this approach is the *only* meaningful way of calculating the cost of a hotcut for purposes of making a comparison to other states. AT&T appears to recognize that amortizing the NRCs is necessary to provide a meaningful comparison, but suggests that Verizon has combined the recurring and nonrecurring charges for hotcuts "in some entirely unexplained fashion." *March 1 Ex Parte* at 2. Verizon's methodology is quite simple.

Verizon merely multiplied the applicable recurring loop rates plus the applicable recurring cross-connect costs by the applicable number of months (36 for a three-year UNE life, 60 for a five-year UNE life), and added the non-recurring hotcut charge to determine the total charge for a hotcut loop over the UNE life. Verizon then divided the total by 36 or 60 months to determine the per-month rate over three and five years, respectively. *See Garzillo/Prosini Reply Declaration* ¶ 28.

As the previous analysis demonstrates, total hotcut loop rates (recurring and non-recurring) over a 3-year UNE life in New Jersey are *lower* than in Massachusetts, lower than under the previous New Jersey rates, equal to rates in Pennsylvania, and lower than the non-recurring costs determined in New York. AT&T does not seriously dispute this fact, but instead merely asserts that the non-recurring charge should be amortized over a different period, arguing that the appropriate period over which hotcut rates should be spread is actually ********. *See March 5 Ex Parte* at 1. As an initial matter, Verizon's analysis already provided an amortization based on a 36 month period as well as a 60 month period, and that analysis demonstrates that the New Jersey rates are comparable to or lower than cost levels in other states. Moreover, AT&T's assumption is inconsistent with the Board's order. In fact, the New Jersey Board expressly decided at its November 20, 2001 meeting that Verizon should assume that the average UNE life is *five* years for purposes of calculating its non-recurring costs, and its directive to that effect was submitted as part of the application here. *See* November 20, 2001 Letter from Henry M. Ogden to Bruce D. Cohen, Esq. ("Secretary's Letter") (App. F, Tab 6) at 2 (directing that "Service Disconnection should be increased to five (5) years"); *see also Final Order* at 163-64 ("We are unconvinced that customer turnover occurs every 2.5 years and FIND that 5 years is a reasonable assumption."). When a UNE life is extended to that length — or any length beyond three years

— rates in New Jersey are lower than in Massachusetts or Pennsylvania, lower than the previous New Jersey rates, and lower than the costs determined in New York.

Moreover, the total hotcut rate in New Jersey is nearly equal to that in Massachusetts and Pennsylvania, and lower than the costs determined in New York, even using AT&T's assumptions of ********. As we explained above, the total rate for a hotcut in New Jersey is lower than or equal to rates elsewhere at 36 months. Even at ********, hotcut rates in New Jersey are still lower than the previous New Jersey rates, and of course are lower than the costs determined in New York, where both the statewide average loop rate and the non-recurring hotcut cost determined by the New York PSC exceed the analogous costs in New Jersey. And, even using the low end of AT&T's range (which is three years shorter than the UNE life the Board found reasonable), the combined rates in New Jersey are only slightly more expensive than in Massachusetts and Pennsylvania ********.

In addition, AT&T claims that the recent New York order determining the non-recurring cost to complete a hotcut should be disregarded because, as part of a broad settlement of several pending matters, those rates have temporarily been capped at $35.00. *See March 1 Ex Parte* at 2. AT&T is being disingenuous. The fact remains that the New York PSC, in an order that otherwise diminished Verizon's UNE rates substantially, found that the non-recurring cost associated with performing a hotcut was $185.19 when no premises visit is necessary. *See* Recommended Decision on Module 3 Issues, *Proceeding on Motion of the Commission to Examine New York Telephone Company's Rates for Unbundled Network Elements*, Case 98-C-1357, at App. C, Schedule 1, Page 11 (May 16, 2001) (proposing New York rates); Order on Unbundled Network Element Rates, *Proceeding on Motion of the Commission to Examine New York Telephone Company's Rates for Unbundled Network Elements*, Case 98-C-1357, at 139-45,

161-62 (NY PSC Jan. 28, 2002) ("*New York UNE Order*") (accepting recommended decision's rates). Pursuant to a comprehensive negotiated settlement agreement between Verizon and the New York Department of Public Service Staff that (among other things) permits Verizon to raise retail rates, Verizon has agreed for a two-year period to credit hotcut payments over $35.00 back to the CLEC. The tariff, therefore, shows a hotcut rate of $185.19, but then indicates that Verizon will credit CLECs with amounts over $35.00. *See* Attachment 1 (relevant tariff page). The agreement makes clear, however, that the $185.19 figure still represents "the cost-based rates established in the Commission's UNE Rate Order for [hotcut] procedures." Joint Proposal Concerning Verizon Incentive Plan, attached hereto as Attachment 2, at 2. In sum, the $35.00 figure is not the cost at all, but rather a negotiated charge agreed to in settlement of various issues, including but not limited to non-recurring hotcut costs. And, of course, the only cost-based rate determined by the New York Commission is actually higher than the rate determined by the New Jersey Board.

II. Verizon's Non-Recurring Hotcut Rates Reflect the Fiber/Copper Breakdown Ordered By The Board.

AT&T's second argument is that the non-recurring cost model used to determine the New Jersey non-recurring hotcut rates fails to "incorporate the forward-looking assumptions ordered by the New Jersey [Board]" because — it claims — the non-recurring model has not been amended to reflect the hypothetical 60% IDLC/40% copper breakdown that the Board adopted for use in determining recurring costs. *March 1 Ex Parte* at 3-4. Even setting aside the fact that a non-recurring cost model need not include the same network assumptions as for recurring costs, AT&T's assertions are simply wrong. On the contrary, the Board's orders that were filed

as part of the original application here make clear that the Board adopted the same assumptions for use in the non-recurring model that it adopted for recurring costs.

The Board adopted and announced its decision on the pricing of unbundled network elements at its regularly scheduled public meeting on November 20, 2001. *See* App. F, Tab 5. At that meeting, the Board evaluated non-recurring cost models submitted by Verizon and by AT&T, and decided that, while the two models were similar in their approach, the Verizon model should be used as the appropriate starting point in determining non-recurring costs. The Board also decided, however, that many of the inputs to that model should be changed, and directed the issuance of a secretarial letter detailing the changes and requiring Verizon to re-run the study with the Board-specified inputs. The secretarial letter (which was included with the application at App. F, Tab 6 and is included here as Attachment 3 for convenience) was issued that same day. Among other things, the *Secretary's Letter* directed Verizon to re-run the non-recurring cost model incorporating "all the aforementioned revisions" that the Board had adopted for use in computing recurring cots, including the same network technology assumptions. *See Secretary's Letter* at 2. It also directed Verizon to modify a number of additional inputs in response to the claims of other parties during the state proceeding. For example, the Board required Verizon to revise the time it takes to perform various tasks and to eliminate tasks (including some manual tasks) that the Board deemed unnecessary in a forward-looking network. *See id.* at 2-3; *Garzillo/Prosini Reply Declaration* ¶ 25 (listing modifications). On December 3, 2001 and December 10, 2001, at the Board's request, Verizon filed revised cost studies reflecting the inputs that the Board determined were TELRIC-compliant at the November 20, 2001 meeting. *See* App. F, Tabs 7 & 8. Among other things, these revised cost studies reduced the

nonrecurring rate for an analog hotcut based on the Board's inputs. On December 17, the Board released its *Summary Order* formally adopting the lower hotcut rate. *See* App. F, Tab 9.

The *Summary Order* and "[t]he Attachments to th[at] Order present the Board's findings for *all* recurring and non-recurring rates, as well as the results of Verizon model re-runs based upon the Board-approved inputs." *Summary Order* at 1. Among other things, the Board's *Summary Order* again made clear that, while it had adopted Verizon's non-recurring cost model, it also had required changes to many of the inputs. For example, the Board expressly ordered that, for purposes of determining the non-recurring rates listed in the attachments to that Order, "the mix of DLC systems ha[d] been adjusted to be consistent with the assumptions recommended previously for use in the recurring cost model." That Order, a copy of which is attached for convenience at Attachment 4, was issued on December 17, 2001, and was included with Verizon's application, *see* App. F, Tab 9. As a result, it has long been clear that the Board adopted the same assumptions regarding underlying network technologies for purposes of determining both recurring and non-recurring rates. And this fact is only further confirmed by the Board's *Final Order*, which reiterated that the Verizon NRCM had been adjusted to be "consistent with[] the Board's findings [regarding] all inputs and the associated assumptions" relating to recurring charges. *Final Order* at 161. Thus, the Board-ordered hotcut rates — like other Board-ordered non-recurring rates — *do* account for the IDLC/copper breakdown adopted by the Board for recurring rates.

Perhaps recognizing the fundamental flaw in its argument, AT&T goes on to erroneously suggest that Verizon nevertheless should charge a blended non-recurring rate that constitutes a weighted average of non-recurring costs for digital and analog hotcuts. *See* Walsh Declaration ¶¶ 28-30. But this claim does nothing more than quarrel with the Board's decision to establish

separate NRCs for analog and digital hotcut rates. Precisely because hotcuts from IDLC and hotcuts from copper (or UDLC) involve entirely *different* elements and require different processes, they are subject to different non-recurring charges. *See, e.g.*, Ex Parte Letter from Clint E. Odom, Verizon, to Magalie Roman Salas, Secretary, Federal Communications Commission (January 25, 2002) ("Cost Studies Ex Parte") (attaching Verizon cost studies, including compliance non-recurring cost study).[1] The rates are different because IDLC hotcuts require extra steps. In order to be transferred to the CLEC switch, an IDLC loop must first be converted to copper or UDLC facilities. This is essentially a "double" hotcut because both ends of the loop — the central office end and the customer premises end — have to be changed over to a new copper or UDLC loop in a coordinated fashion to minimize the time the customer is out of service. After that conversion, Verizon must then perform a second hotcut which includes the same activities it must perform for a 2-wire analog hotcut loop. The cost of an IDLC hotcut is therefore somewhat higher than the cost of a copper hotcut, as reflected in Verizon's compliance filing and in the Board-approved rates. Because the two types of hotcuts incur different costs and are categorized as different elements, it would be inappropriate to apply some sort of "weighted average" of IDLC hotcuts and copper hotcuts. When a CLEC requests a hotcut of a copper loop, one rate applies; when it requests a hotcut of an IDLC loop, another applies.

III. Verizon Does Not Double-Recover Disconnection Costs.

AT&T also takes issue with the Board's treatment of disconnect costs in establishing non-recurring charges. Again, however, AT&T's claims are misplaced.

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[1] Initial two-wire analog hotcuts are described in Verizon's NRCM as cost element number three; initial two-wire IDLC hotcuts constitute cost element number five. *See Cost Studies Ex Parte*. Charges for additional lines, which apply when CLECs order multiple lines together, are described as cost elements four and six. *See id.*

As an initial matter, AT&T argued during the state proceeding that disconnect costs should not be considered in establishing non-recurring costs. But the Board disagreed. In fact, in its *Summary Order*, the Board cited AT&T's failure to take disconnect costs into account as one of the reasons for not using AT&T's non-recurring cost model. *See Summary Order* at 7. And it made clear that "Verizon should be permitted to collect disconnect costs at the time of installation," because it both "is consistent with retail ratemaking practices, and protects Verizon in the event that a CLEC goes out of business." *Id.* at 8. This also is consistent with the decisions of other state commissions.

Here, AT&T changes horses and also claims that Verizon is double-recovering disconnection charges. *See* Walsh Declaration at ¶ 17. This is not the case. It is true that Verizon collects disconnection costs from its retail customers at the time that they initiate service. But the "connect" costs associated with a hotcut, when a retail customer chooses to migrate to a Verizon retail competitor, account only for Verizon's costs for connecting a hotcut beyond those associated with the disconnection of the end-user's service.[2] Together, the hotcut "connect" costs and the retail "disconnect" costs account for the total costs associated with migrating the end user. There is no double charging. For example, the "disconnect" charge that is applied when Verizon first signs up a retail customer covers the disconnection and removal of the main distribution frame jumper cable between the Verizon cable pair and Verizon's office equipment and the cost of removing certain translations from the switch. The "connect" cost

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[2] Verizon's NRCM accounts for the costs associated with both connecting and, at the end of the UNE life, disconnecting the UNE. The latter cost is reduced to the "present value" of the forward-looking disconnection charge. In New Jersey, the expected UNE life used to determine the present value of disconnection costs in New Jersey is five years. *See Secretary's Letter* ("Service Disconnection should be increased to five (5) years."); *see also Final Order* at 163-64.

associated with a hotcut does *not* include those expenses, even though those activities must be performed during a hotcut. Those costs, rather, are only recovered through charges applied when the retail customer establishes service.

Finally, of course, Verizon will incur a separate set of disconnection charges when the CLEC discontinues the hotcut loop. These costs, which are wholly distinct from the activities performed at the beginning of the hotcut loop UNE life, are recovered through the "disconnect" non-recurring hotcut charges. Thus, Verizon does not double-recover disconnect costs.

IV. Verizon's Hotcut Procedures and the Attendant Costs are Justified and TELRIC-Compliant, As the Board Found.

AT&T also provides — for the first time in this proceeding — a detailed declaration setting out what it claims is the correct non-recurring hotcut rate. Even aside from the IDLC/copper issue, AT&T's basic assertion is that Verizon's hotcut process is somehow less than efficient, even though it was designed in collaboration with other carriers to ensure the close cooperation which is necessary to avoid a service outage. AT&T's claims are based on misstatements and misunderstandings of the hotcut process. The result is an extraordinarily low proposed "blended" non-recurring hotcut rate that is less than 3% of the rate set by the Board. *See* Walsh Declaration ¶ 27.

First, AT&T ignores the fact that the New Jersey Board already has addressed its arguments regarding the efficiency of Verizon's hotcut process. During the state proceeding, AT&T's non-recurring costs witness and Verizon's non-recurring cost witness each submitted written testimony on the appropriate assumptions for use in computing non-recurring costs. *See Prosini/Garzillo Reply Declaration*, Attachment 1 (Meacham Direct); *Verizon February 20 Ex Parte*, Attachment 3 (Meacham Rebuttal Excerpts); *AT&T March 1 Ex Parte*, Walsh

Declaration, Exhibit 1 (Walsh Rebuttal). To the extent AT&T's witnesses addressed hotcuts specifically, Verizon's cost witness provided a detailed rebuttal in testimony that is part of the record here. *See Verizon February 20 Ex Parte*, Attachment 3. As noted above, the Board made clear that it had considered and addressed those arguments and made various adjustments to Verizon's NRCM, including eliminating costs for what it considered "unnecessary manual steps, such as retyping orders" and reducing or eliminating costs that it considered to be based on "unrealistic time estimates." *See Summary Order* at 7-8; *Final Order* at 163; *Garzillo/Prosini Reply Declaration* ¶ 25. These revisions resulted in a decrease in hotcut costs for both analog and digital hotcuts. *See Cost Studies Ex Parte*. And the Board's *Final Order* merely confirms yet again that the Board considered and addressed AT&T's claims. *See Final Order* at 142-68.

Moreover, AT&T's claim that the Board erred by allowing Verizon to recover its forward-looking non-recurring costs is at best a parody of reality. AT&T's basic claim is that the only reasons those costs will be incurred in the future (and even it concedes they will) are that Verizon's hotcut process is somehow defective or that the costs supposedly would not be incurred in a hypothetical future network. It is wrong on both scores.

First, the reality is that the hotcut process employed by Verizon was developed in formal and informal collaborative discussions with CLECs, including AT&T. The entire purpose of that process was to correct perceived weaknesses in the process employed by Verizon and CLECs alike, and to ensure the close cooperation needed to avoid outages. Based on that, Verizon reworked its processes in response to CLEC demands, and it is those very processes which are now criticized by AT&T as inefficient. *See Garzillo/Prosini Reply Declaration*, Attachment 1 (Meacham Declaration); *February 20 Ex Parte* at 6-7 & Attachment 3 (Meacham Rebuttal). And in reality, Verizon's hotcut performance is excellent, directly refuting the claim that the

underlying processes are in some unspecified sense defective. *See Lacouture/Ruesterholz Declaration* ¶¶ 89-97 (detailing hotcut performance); *Rhode Island Order* ¶ 83 (discussing hotcut performance); *Pennsylvania Order* ¶ 86 (same). What's more, those underlying processes themselves have been awarded accolades by independent standards bodies.

Verizon's hotcut process received the prestigious ISO-9000 certification from the International Standards Organization. This independent certification demonstrates that Verizon has a high-quality and well-developed structure in place for handling hotcuts. Verizon's hotcut processes were recertified by ISO in May, 2001, and again in November, 2001. *See Lacouture/Ruesterholz Declaration* ¶ 90. AT&T neglects to mention, too, that Verizon also has developed procedures that make its process *more* efficient. For example, Verizon and several CLECs have developed a process to perform multiple hotcuts on a project basis, which helps to eliminate numerous phone calls between Verizon and the CLEC. Verizon has also developed a web-based system to track and manage hotcut orders. *See id.* ¶ 93.

AT&T's approach, which the Board rejected as one of its many efforts to "assume[] away" relevant costs, *see Summary Order* at 6, is based on an imaginary automated alternative to Verizon's processes in which instructions are sent to the old (disconnecting) switch to terminate (or shut-down) service to that switch and within a few seconds, a similar instruction is sent to the new switch to turn-on translations. *See* Walsh Declaration at ¶ 23. AT&T provides no evidence that Verizon or any other company is capable of implementing its hypothetical automatic hotcut process. That is because none exists. *See, e.g.*, Verizon February 20 Ex Parte, Attachment 3 (Meacham Rebuttal). The hotcut process is designed to move a POTS loop that is in service from Verizon's switch to the CLEC's switch. This requires coordinated work efforts by both Verizon and the CLEC that cannot be automated simply, as AT&T suggests. *See*

Lacouture/Ruesterholz Declaration ¶ 92. For example, Verizon does *not* simply turn off its dial tone at the exact date and time scheduled for migration. Typically, unconditional 10-digit trigger technology is employed (to ensure successful Number Portability after the Hotcut) and the Verizon dial tone is disconnected at 11:59 pm on the date due — well after the customer has been migrated to the CLEC. Meanwhile, the CLEC is expected to have its dial tone activated two days prior to the due date. This process allows the CLEC, Verizon, and customer to resolve any problems before the scheduled date and time of the hotcut. *See Lacouture/Ruesterholz Declaration* ¶¶ 92-93. The entire process is designed to ensure a smooth transition of service and to minimize service interruption for the end user because, as this Commission has noted, "[t]he ability of a BOC to provision working, trouble-free loops through hot cuts is of critical importance in view of the substantial risk that a defective cut will result in end-user customers experiencing service disruptions that continue for more than a brief period." *New York Order* at ¶ 299.

And, indeed, these procedures are demonstrably necessary to minimize service interruptions. Verizon analyzed the hotcuts performed during December for two CLECs in New Jersey. For one CLEC, Verizon completed 68 hotcut orders, and its processes detected and helped to correct CLEC-caused problems affecting 9, or 15%, of those orders. For the other CLEC — ******** — Verizon completed 40 hotcut orders; on 12 of those orders, or *30%*, Verizon's processes detected and helped to correct problems attributable to ******** that would otherwise have placed the end user out of service. *See Lacouture/Ruesterholz Reply Declaration* ¶ 17.

In the end, AT&T's attempt to assume away the non-recurring costs to perform a hotcut is no different from previous arguments that this Commission has expressly rejected. For

example, AT&T and others have argued elsewhere that Verizon and other ILECs should not be allowed to recover their costs of performing loop conditioning on behalf of other carriers on the theory that, in a hypothetical idealized future network, it might not be necessary to condition loops. But the Commission has rejected that claim, and held expressly that ILECs are entitled to recover the non-recurring costs that they incur to condition loops on behalf of other carriers.[3] In fact, the Commission expressly held that, even if it were *true* that loops in a network built today would not need to be conditioned, ILECs nonetheless are entitled to recover the costs that they incur to condition loops an another carrier's behest.[4] AT&T's spurious claims here are no different.

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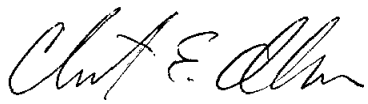
[3] *See New York Order* ¶ 259 ("[T]he Commission has clearly stated that incumbent LECs, if required to condition loops, may recover their costs of such conditioning."); *Texas Order* ¶ 248 (""In order to provide the requested loop functionality, such as the ability to deliver ISDN or xDSL services, the BOC may be required to take affirmative steps to condition existing loop facilities to enable competing carriers to provide services not currently provided over the facilities, with the competing carrier bearing the cost of such conditioning."); FCC Reply Brief, *Verizon Communications, Inc. v. FCC*, Sup. Ct. Nos. 00-511, 00-555, 00-587, 00-590 and 00-602, at 9-10 n.7 (citing to "express FCC directions" that incumbents should be permitted to recover loop conditioning costs"). *See also Local Competition Order* ¶ 382 ("Some modification of incumbent LEC facilities, such as loop conditioning, is encompassed within the duty imposed by section 251(c)(3). *The requesting carrier would, however, bear the cost of compensating the incumbent LEC for such conditioning.*") (emphasis added).

[4] *See UNE Remand Order* ¶¶ 192-93 ("We agree that networks built today normally should not require voice-transmission enhancing devices on loops of 18,000 feet or shorter. Nevertheless, the devices are sometimes present on such loops, and the incumbent LEC may incur costs in removing them. *Thus, under our rules, the incumbent should be able to charge for conditioning such loops.*") (emphasis added).

Please let me know if you have any questions. The twenty-page limit does not apply as set forth in DA 01-2746.

Sincerely,



Clint E. Odom

Attachments

cc: A. Johns
S. Pie
R. Lerner
D. Shetler
J. Swift